Minimizing Taxes, Maximizing Your Estate with Corporate Insurance

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As a business owner you know the effects of tax on your earnings and savings. You may even be aware of the punitive costs your heirs will incur when they attempt to liquidate those investments when you pass away. There's a planning technique for businesses with excess liquid assets or cash flow that could reduce your taxes payable and increase the value you pass on to heirs.

The challenge for most business owners, regardless of whether they own an operating company ("OpCo"), holding company ("HoldCo"), or both, is how to maximize the benefit from all your hard work. The Corporate Investment Shelter strategy is designed for business (must be a Canadian-controlled private corporation) owners with surplus corporate assets – investments in excess of what is needed for corporate or personal needs. This innovative concept uses permanent life insurance to reduce taxes payable on these investment assets and maximizes the estate value to your loved ones (because it's based on life insurance you must qualify for the life insurance coverage).

Tax-exempt life insurance provides a unique financial instrument that allows you to provide traditional insurance-based protection and tax-sheltered investment growth. Deposits in excess of the minimum amount to pay insurance costs can grow tax-exempt, while the proceeds received as a consequence of death are tax-free (including any accumulated growth).

Corporate life insurance proceeds in excess of the adjusted cost basis (ACB) of the policy create Capital Dividend Account (CDA) credits which your corporate beneficiary can use to declare and pay out a tax-free dividend. Any remaining insurance proceeds can be paid out using taxable dividends. The CDA is a notional tax account that permits the tax-free flow through of

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certain amounts to the shareholders of the corporation.

This strategy is ideal for individuals who own a holding company and:

- Don't require the income from the holding company
- Have excess income distributed from their operating company to their holding company
- Wish to pass proceeds to any remaining shareholders or to the estate

Process

1. The corporation can use excess earnings, which would otherwise be invested in taxable vehicles, to fund a tax-exempt life insurance policy. The corporation must be the owner and beneficiary (further advantages may be obtained by naming OpCo as the beneficiary of a policy owned by HoldCo, if possible) of the policy, and the shareholder must be the insured.
2. Once the insurance costs are subtracted, the remaining deposits are invested and grow on a tax-sheltered basis in the policy. Those assets can be accessed for future use through a strategy that incorporates tax-free loans from a financial institution.
3. Upon death of the shareholder, the insurance proceeds are payable to the corporation, tax-free.
4. The insurance proceeds create a credit in the corporation's Capital Dividend Account (CDA), which can then be used to pay a tax-free, capital dividend to the shareholder's estate (proceeds can be paid through the CDA to any shareholder). The amount of the credit in the CDA is equal to the entire death benefit proceeds minus the Adjusted Cost Basis of the policy. Any proceeds in excess of the CDA credit can be paid to the estate as a taxable dividend.
5. The estate can use the net proceeds in a number of ways, based on the shareholder's needs and wishes.

Benefits

The Corporate Investment Shelter offers several benefits. This strategy can:

- Maximize the size of the estate to be passed on
- Create additional funds to make charitable donations, which in turn create even greater tax advantages
- Equalize the estate if the company is being passed on in its entirety to only one child
- Increase the rate of return on corporate assets by sheltering them from annual corporate taxes
- Protect your company from liquidation by using the insurance proceeds to fund capital gains taxes that are incurred upon death

1. Corporation

Reallocates surplus savings and cash flow into an insurance policy.

2. Tax-Exempt Life Insurance

Deposits in excess of policy costs grow tax-deferred.

3. Corporation

Tax-free death benefit paid to corporation is now available to pay dividends.

4. Beneficiary Shareholders

Capital dividend account credit provides tax-free dividend withdrawal – remaining taxable amount (if any) is paid out as a taxable dividend.

Key: You never lose control and have a variety of methods to access the funds if needed.

The corporate investment shelter strategy considerably increases the value for your family/beneficiary shareholders and lowers the tax your business pays today. Corporate life insurance allows for tax-free dividends to beneficiary shareholders and therefore reduces the tax owed personally on withdrawing assets and maximizes value.

Further advantages may be obtained by naming OpCo as the beneficiary of a policy owned by HoldCo, if possible.

Learn how to maximize the opportunities of your hard work.

Corporate Investment Shelter Case Study

Fred and Helen (both 60) have two children and two grandchildren, a retirement plan, and a business which they are in the process of winding up. They have been transferring their OpCo's excess income to their HoldCo using tax-free inter-corporate dividends and have around $1 million in their HoldCo. They've set money aside from their HoldCo to supplement their retirement income and the remaining balance is earning interest in a fixed-income portfolio and will eventually be passed on to their children. While they have a plan they are certainly not maximizing their opportunities and some of their hard work may be lost to tax before it gets to their children.

Fred and Helen consider the Corporate Investment Shelter strategy for a portion of their HoldCo investments. They decide to reallocate $59,750 per year for 10 years into this plan which starts with a $1 million life insurance benefit. These funds will grow tax exempt and are still accessible in a variety of ways. When they both pass away the corporation receives the insurance benefit and a credit to its Capital Dividend Account. This allows some or all of the proceeds to be paid out as a tax-free capital dividend.

This solution not only relieves the corporation of ongoing tax on the interest growth and provides optimal tax-exempt growth, but when held until death it also maximizes the net after-tax estate to their children from their otherwise trapped corporate investments.

The Internal Rate of Return (IRR) for a series of life insurance deposits, specifies the percentage rate of return earned by those deposits in relation to the life insurance benefit received in future time periods. IRR is a method frequently used to assess whether or not the insurance benefit is providing value for your deposits over your projected lifetime.

Net Estate Value to Beneficiary Shareholders

Corporate Tax-Exempt Life Insurance							Corporate Fixed Income	
Cash Value	Death Benefit	IRR on Death Benefit	CDA Credit	Net Estate to Shareholders	Year	Age	Cash Value	Estate to Shareholders
$ 22,916	$ 1,074,215	1697.8%	$ 1,016,296	$ 1,053,132	1	61	$ 61,218	$ 39,401
149,260	1,403,065	56.9%	1,119,303	1,299,776	5	65	321,500	211,700
465,561	1,925,286	20.6%	1,382,031	1,727,541	10	70	684,475	462,950
704,055	1,998,230	11.7%	1,534,418	1,829,402	15	75	772,775	547,152
1,155,510	2,156,311	8.4%	1,828,105	2,036,844	20	80	872,466	642,218
1,507,297	2,405,807	6.9%	2,266,902	2,355,246	25	85	985,017	749,548
1,877,998	2,649,437	6.0%	2,649,437	2,649,437	30	90	1,112,088	870,723

Source: Sun Life Financial, as of January 2012 – joint last-to-die whole life insurance with deposits of $59,750 per year for ten years. Based on a current dividend scale which is not guaranteed. Assumes a corporate tax rate of 46.57%, shareholder dividend tax rate of 36.35%, and a 4.6% fixed income rate of return.

The Process

1	The company is the owner and beneficiary of the policy and pays premiums from excess earnings.	**DEATH BENEFIT + TAX-DEFERRED ACCUMULATION**
2	Deposits are invested in a diversified manner and grow in a tax-sheltered environment. This adds a layer of diversification to the shareholder's investment portfolio.	
3	The death benefit is paid to the company tax-free when the shareholder dies.	**CORPORATION** Must be a Canadian-controlled private corporation.
4	The corporation pays the proceeds of the death benefit to the shareholder's estate via the Capital Dividend Account (CDA). The credit is equal to the insurance benefit received by the corporation minus the Adjusted Cost Basis (ACB) of the policy. It allows a tax-free capital dividend to be paid to the shareholder.	**SHAREHOLDER**
5	The estate can use the proceeds for various objectives, for instance, to fund tax liabilities, equalize shares of inheritance or distribute social capital to charities and foundations.	**ESTATE**

Please contact us for more information about corporate insurance.

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